RESEARCH

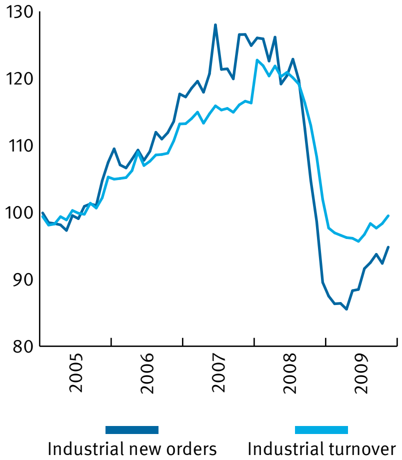
2010
EUROPEAN LOGISTICS & INDUSTRIAL
Market report

Knight Frank

HIGHLIGHTS

- Prime logistics rents fell across much of Europe during 2009, as demand for space weakened in response to the wider economic uncertainty. However, rental declines were generally less severe than those seen in the office sector.
- Though occupier market activity has been subdued, those transactions that have taken place have reduced the availability of good quality vacant space. The supply of prime space is likely to tighten further in many markets during 2010, as speculative development activity has largely dried up across Europe.
- Industrial investment volumes in 2009 were more than 50% down on the previous year. However, with prices stabilising and financing constraints gradually easing, transactional activity is showing signs of improvement. Investors are mainly focused on prime properties in the core Western and Northern European markets.

Figure 1
European Union industrial activity indicators
Index, 2005=100



Source: Eurostat

Table 1
Logistics Performance Index - Top 20 European countries

European rank	Global rank	Country	Score
1	1	Germany	4.11
2	3	Sweden	4.08
3	4	Netherlands	4.07
4	5	Luxembourg	3.98
5	6	Switzerland	3.97
6	8	UK	3.95
7	9	Belgium	3.94
8	10	Norway	3.93
9	11	Ireland	3.89
10	12	Finland	3.89
11	16	Denmark	3.85
12	17	France	3.84
13	19	Austria	3.76
14	22	Italy	3.64
15	25	Spain	3.63
16	26	Czech Republic	3.51
17	30	Poland	3.44
18	34	Portugal	3.34
19	37	Latvia	3.25
20	38	Slovakia	3.24

Source: World Bank, 2010

The LPI scores 155 countries on their logistics "friendliness", based on a world survey of international freight forwarders and express carriers.

Logistics and industrial market overview

The development of Europe's logistics and industrial property markets is closely tied to trends in manufacturing and retail activity across the continent. Location is of key importance to logistics occupiers, and demand is mainly focused on properties that provide access to transport links enabling the distribution of goods across Europe and beyond.

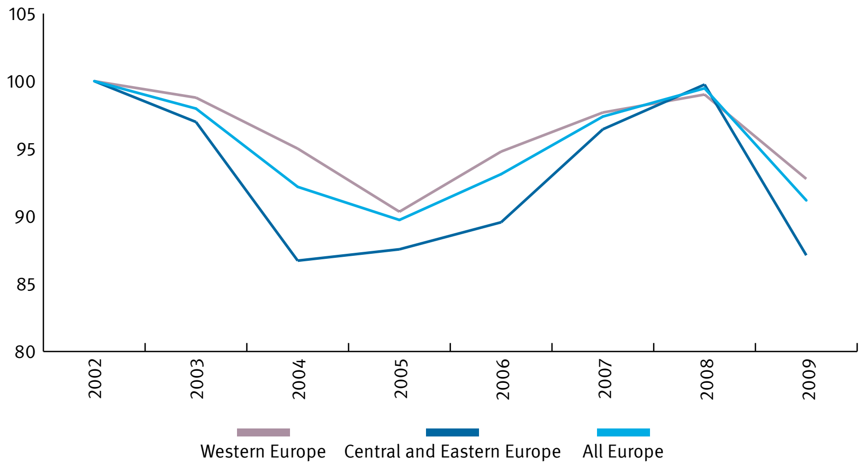
The heartland of Europe's logistics market is the area in and around the Benelux region, stretching into north east France and the Rhine-Ruhr region of Germany. The Benelux region includes major transport hubs including Amsterdam's Schiphol airport and the seaports of Rotterdam and Antwerp, and is an important gateway to the rest of Europe. However, the last decade has also seen a shift of activity towards the east, with the economies of the CEE area becoming more closely integrated with Western Europe, and logistics occupiers and developers attracted by the lower labour and build costs of this region.

As was the case for all property sectors, 2009 was a challenging year for Europe's industrial and logistics markets. Demand for space waned, reflecting the overall weakness of the European economy and, in particular, uncertainty in the manufacturing and retail sectors. The primary concern of many occupiers has been the need to reduce costs and increase the efficiency of their occupied space. As such, many tenants have sought to renegotiate leases, sublease space or consolidate their operations into fewer sites.

Major logistics companies require increasingly modern, flexible and large-scale distribution centres that enable the efficient throughput of goods. However, such properties are a relatively new phenomenon in much of Europe, having only started to appear in the 1990s, and modern supply remains scarce in many countries, including the key markets of Germany, France and the Netherlands. Much of the continent's industrial stock is in older properties, which are increasingly vacant or obsolete.

Construction activity slowed across Europe in 2009, and with developers reluctant or unable to finance speculative projects, the current development pipeline is dominated by build-to-suit properties. However, significant amounts of new space, the construction of which had been commenced in 2006-2008,

Figure 2
Prime logistics rent movements
Index, 2002=100



Source: Knight Frank
Based on weighted averages of prime rents in major European markets

were added to CEE markets in 2009. With supply outstripping demand in the region, vacancy rates have been pushed upwards.

Industrial rents have fallen, though generally by lesser degrees than has been seen in the office sector. Rental levels have remained relatively robust in Germany and the Benelux countries. However, more substantial falls in rents have been seen in those countries where the economy has been weakest, including Ireland and Spain, as well as markets where significant levels of new supply have continued to come on stream such as the CEE countries.

European logistics map

Table 2
Busiest seaports by cargo traffic

Rank	Seaport	Country	Total cargo handled (million tonnes)
1	Rotterdam	Netherlands	384.2
2	Antwerp	Belgium	171.2
3	Hamburg	Germany	118.9
4	Marseille	France	92.5
5	Le Havre	France	75.6
6	Amsterdam	Netherlands	74.4

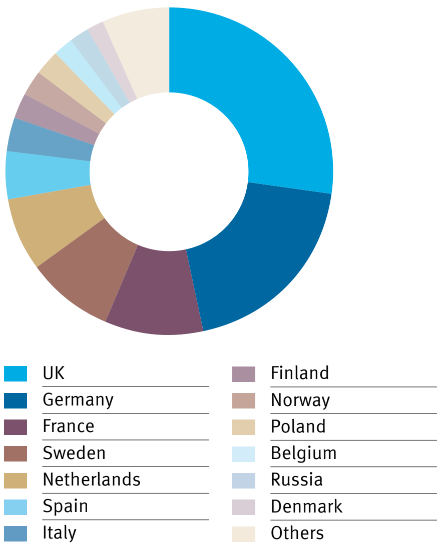
Source: Eurostat, 2008

Table 3
Busiest airports by cargo traffic

Rank	Airport	Country	Total cargo handled (tonnes)
1	Paris Charles de Gaulle	France	2,280,050
2	Frankfurt	Germany	2,111,031
3	Amsterdam Schiphol	Netherlands	1,602,585
4	London Heathrow	UK	1,486,260
5	Luxembourg Findel	Luxembourg	788,224
6	Brussels	Belgium	659,054

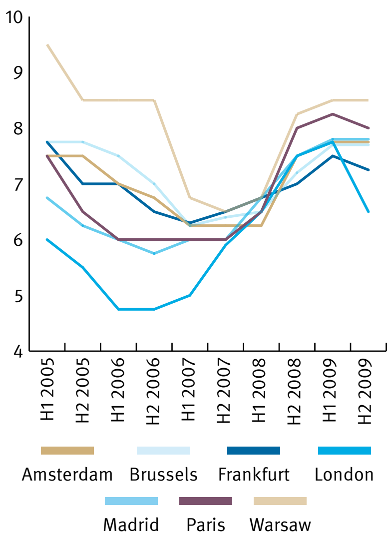
Source: Airports Council International, 2008

Figure 3
Destination of industrial investment, 2007-2009
%



Source: Knight Frank/Real Capital Analytics

Figure 4
Logistics prime yield movements
%



Source: Knight Frank

Investment market overview

The industrial sector accounts for around 10% of overall European commercial property investment volumes. Activity is generally concentrated in a few major markets; with over half of all industrial investments during the period between 2007-2009 taking place in the UK, Germany and France.

As rental movements tend to be less volatile, the sector is often perceived as offering more stable income returns than office or retail properties. Though rapid rental growth is unlikely, so too are severe falls in rental values. Thus, industrial properties can provide relatively secure, stable income and may be good defensive investments through times of market downturn.

Though industrial investment volumes were down across the whole continent in 2009, the UK's share of the overall European market rose markedly; from 24% in 2008 to 43% in 2009. Investor interest in the UK was boosted by sharper, and earlier, price corrections than were seen in most of the rest of Western Europe, while the weakness of the Pound against the Euro also helped the market to appear attractive to cross-border investors, including the German funds.

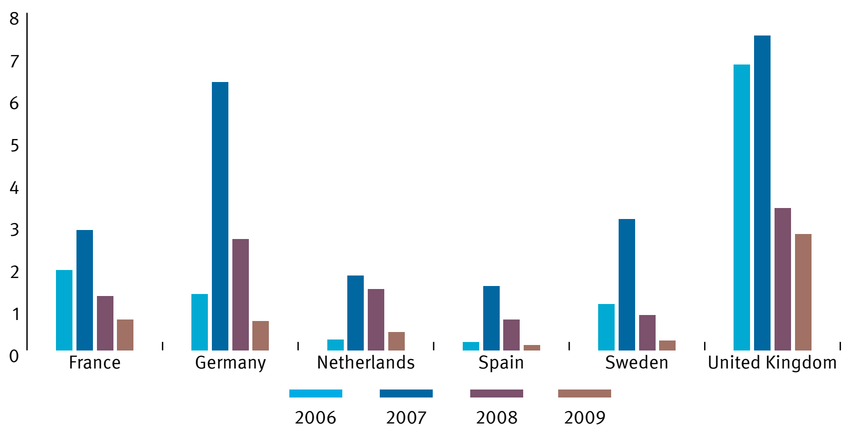
The largest industrial deal of 2009 was the UK investor Max Property Group's purchase of a portfolio of assets from the receivers of the collapsed Industrious Group for £227 million (€252 million). However, there were fewer distressed sales throughout the year than many had anticipated.

Current investor interest is focused on prime properties let to strong covenants on long leases in the core Western European markets of the UK, France, Germany and the Benelux. There is currently little interest in secondary properties and activity in the emerging markets of the CEE region has cooled.

Historically, prime industrial yields have tended to run several percentage points higher than office and retail yields. Prior to the recent downturn, prime logistics yields had moved closer to those in the office sector, but the spread between office and logistics yields has since widened again.

Industrial prime yields across Europe converged into a narrow band in the middle of 2008, with yields in the emerging markets of the CEE region compressing closer to Western European levels. In H1 2008, prime yields in Warsaw were just 25 basis points above London. However, this gap has now widened to about 200 basis points, reflecting the withdrawal of investor activity away from the Eastern markets back to Western and Northern European centres. During Q4 2009, prime yields appeared to stabilise in most European markets, but hardened significantly in the UK.

Figure 5
Industrial investment volumes
€ billion



Source: Knight Frank/Real Capital Analytics

Occupier market snapshots

In the Netherlands, prime rents are highest in the area around **Amsterdam's** Schiphol airport. There are other major logistics clusters around the seaports of **Rotterdam** and Amsterdam, as well as inland hubs such as **Venlo, Breda** and **Tilburg**. Demand was soft in 2009, but a general lack of development activity has helped to limit rental falls.

The "Golden Triangle" between **Brussels, Antwerp** and **Ghent** is regarded as the key area for Belgian logistics, though industrial clusters also exist around locations such as **Charleroi**, **Liège** and **Limbourg**. There has been very little speculative development activity in the market, severely restricting the choice of properties available to logistics operators. The lack of new supply is likely to support rental levels in 2010.

Prime rents have fallen in the **Bucharest** market and landlords have needed to offer increased incentives in order to attract tenants. The vacancy rate has been rising, but the amount of new space being released to the market has now slowed considerably.

Take-up in the **Dublin** market during 2009 was significantly down on recent years, though activity picked up in the second half of the year. The market is suffering from high vacancy rates, though a large amount of the empty space is in older properties that have been on the market for some time.

The location of Germany, at the heart of Europe, makes it central to the continent's logistics networks, offering access to both Eastern and Western Europe. Activity is spread over the country; from the port of **Hamburg** in the north to **Munich** in the south, from **Berlin** in the east to the **Rhine-Ruhr** agglomeration and **Frankfurt** in the west. Prime logistics rents were generally stable throughout 2009, though incentives have increased. Supply levels have risen, partly due to release of space for subletting.

The vacancy rate in the **Kiev** warehouse market jumped to around 30% by the end of 2009. Although many new projects have been put on hold, including some in advanced stages of construction, availability could continue to climb in 2010. Rents have fallen substantially, but the pace of decline has now slowed.

The main corridor of logistics activity in France runs down the country, from north to south, through **Lille, Paris, Lyon** and **Marseille**. Take-up levels were down in 2009, though demand held more strongly in these core cities than elsewhere in the country. Warehouse take-up in the Paris (Ile de France) market was about 13% down on the previous year in 2009, according to Immostat data.

Supply in the **Lisbon** market has been rising, with some speculative development activity evident. There is also new space planned as part of the government's "Portugal Logístico" plan. Prime rents have come under downward pressure.

With many logistics property owners and developers in the UK focused primarily on reducing void rates, speculative activity has dried up. This may lead to shortages of quality stock, particularly in sought-after locations in the South East, which could fuel rental growth in 2010. Despite a mild softening of its prime rents, the **London (Heathrow)** market has remained the most expensive place to rent logistics properties in Europe.

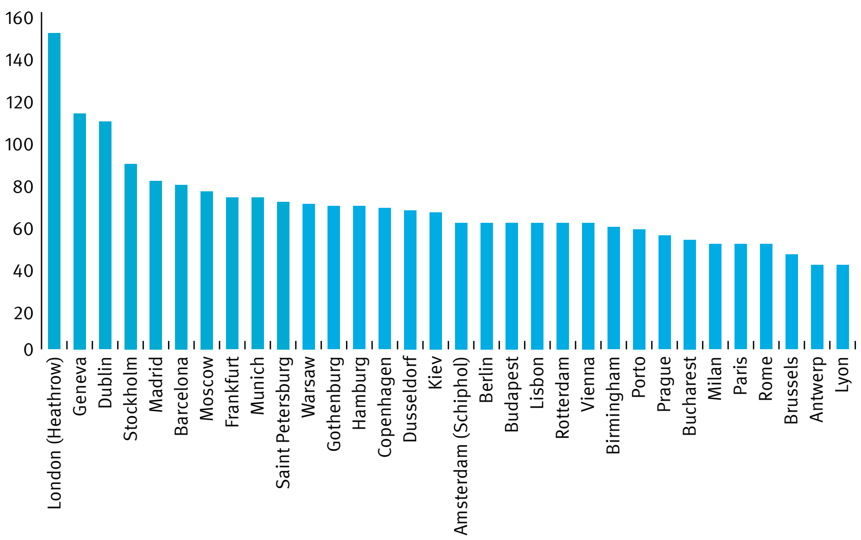
The general weakness of the Spanish economy has been reflected in reduced demand for logistics space in the key markets of **Madrid** and **Barcelona**. Prime rents have seen significant falls, and with the outlook for the Spanish economy remaining poor, the prospects for the market in 2010 appear weak.

Following substantial falls earlier in the year, prime warehouse rents in **Moscow** stabilised by the end of 2009 in the range of US$100-110 per sq m per annum. While new space has continued to come to the market, many development schemes have been put on hold and it is possible that a tightening of supply will push rents back up by the end of 2010.

Vacancy rates in the **Prague** market reached record highs in 2009, as a result of tenants vacating premises and reduced levels of take-up. Increased competition in the market has pushed down rents significantly over the last two years.

Poland has the largest and most highly developed logistics market in the CEE region, which is primarily centred on **Warsaw**, though cities such as **Poznań, Wrocław, Łódź** and **Katowice** have also emerged as growing hubs of activity. Vacancy rates are currently high, though with demand improving during since the middle of 2009, and few new schemes being commenced, the vacant space should begin to be absorbed in 2010.

Figure 6
Prime logistics rents
€ per sq m per annum



Source: Knight Frank

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